

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2013 and 2012

6. RETIREMENT COSTS

Plan Description

The permanent employees of MCE are members of either the Employees' Pension System of the State of Maryland or the Employees' Retirement System of the State of Maryland. Each System is administered by the Board of Trustees for the State Retirement and Pension System of Maryland (the System). The System is an agent multiple-employer public employee retirement system that provides retirement benefits as well as disability and death benefits to plan members and their beneficiaries. The plans are managed by a Board of Trustees in accordance with the State Personnel and Pensions Article, Title 21 of the Annotated Code of Maryland. The benefit provisions and all other requirements are established by Title 20 through Title 38 of this Article of the Code. Plan benefit provisions may only be amended by the State Legislature. The System issues a publicly available financial report that includes financial statements and required supplementary information for the plans. Those reports may be obtained by writing the System at the following address:

State Retirement and Pension System of Maryland
120 East Baltimore Street
16th Floor, Finance Office
Baltimore, Maryland 21202

Funding Policy and Annual Pension Cost

The State Personnel and Pensions Article, Title 21 through Title 23 of the Code establishes the contribution requirements for plan members and MCE. The State's policy, effective July 1, 1980, is to fully fund the costs of the System. Employees who are members of the Employees' Retirement System are required to contribute a specified percentage of their salary. Employees who are members of the Employees' Pension System are required to contribute 7% of all earnable compensation. MCE is required to contribute the remaining amounts necessary to fully fund the System for MCE's permanent employees based on a fixed percentage of payroll determined on an actuarial basis in accordance with the provisions of the aforementioned State law. Specifically, the employer contribution rate is determined using the entry age normal cost method. The System's unfunded actuarial accrued liability is being liquidated over various periods of years depending on when the liability was incurred. The contributions made applicable to MCE employees for the fiscal years ended June 30, 2013 and 2012 were \$1,782,251 and \$1,604,917, respectively. The contributions consisted of \$1,198,860 and \$1,013,662 from MCE and \$583,391 and \$591,285 from employees for the fiscal years ended June 30, 2013 and 2012, respectively. These contributions represented 14.3 % and 12.6% of covered payroll for the fiscal years ended June 30, 2013 and 2012, respectively.

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7. POSTEMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

In addition to the pension benefits described in Note 6, the State provides post-employment health care benefits to retired employees and their dependents. These benefits vary depending upon the employee's year of hire. The State subsidizes approximately 80% to 85% of covered medical and hospitalization costs, depending on the type of insurance plan and the retired employee's length of creditable service. Individual State agencies are assessed a surcharge for post-employment health care benefits that is based on health care insurance charges for current employees.

8. LEASE COMMITMENTS

Effective January 1, 1991, MCE entered into a cancelable operating lease for warehouse space. Rent expense for fiscal years 2013 and 2012 under this lease totaled \$200,000 for each fiscal year. There is no specified term to the lease and future payments are currently set at \$200,000 per year.

Effective April 19, 1999, MCE entered into a cancelable operating lease for office space, beginning February 2000 at an annual rent of \$107,814, subject to periodic adjustments. Rent expense for fiscal years 2013 and 2012 totaled approximately \$150,980 and \$150,308 respectively. There is no specified term to the lease and it is renewed on an annual basis. The lease payment for fiscal year 2014 is estimated at \$158,380.

9. RISK MANAGEMENT

MCE's insurance for general liability, property and casualty, tort liability, workers' compensation coverage and certain employee health benefits are provided by the State under its self-insurance program. The program charges MCE for the costs of servicing and paying claims based upon its percentage of estimated current-year payroll or on its average loss experience. In determining the charges to be allocated, consideration is given to recent trends in the actual claims experience of the State as a whole and provisions for catastrophic losses.

In regard to workers' compensation coverage, the Injured Workers' Insurance Fund administers the State of Maryland's self-insurance program for claims brought against the State under the Workers' Compensation Law. The State of Maryland recognizes a liability in its financial statements for accrued workers' compensation costs applicable to insurance coverage for State employees. This liability is reported at its present value using a 4% discount rate. MCE's portion of the State's liability for accrued workers' compensation costs is recognized in MCE's financial statements.

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Notes to the Financial Statements June 30, 2013 and 2012

9. RISK MANAGEMENT (continued)

The following is the detail of activity for self-insured workers compensation insurance for the years ended June 30, 2013 and 2012:

| | 2013 | 2012 |
|---------------------------------|-------------------|-------------------|
| Beginning of year liability | \$ 355,000 | \$ 379,882 |
| Claims and changes in estimates | 20,227 | 37,675 |
| Claim payments | (48,227) | (62,557) |
| End of year liability | \$ 327,000 | \$ 355,000 |

10. NON-CURRENT LIABILITIES

MCE's non-current liabilities as of June 30, 2013 and 2012, consisted of accrued vacation leave and accrued workers' compensation costs. The account activity during the fiscal years ended June 30, 2013 and 2012, was as follows:

| | 2013 | | | | |
|-------------------------------------|---------------------|-------------------|-------------------|---------------------|-------------------|
| | Beginning Balance | Additions | Deletions | Ending Balance | Current Portion |
| Accrued vacation leave | \$ 1,073,123 | \$ 348,416 | \$ 329,533 | \$ 1,092,006 | \$ 819,067 |
| Accrued worker's compensation costs | 355,000 | 20,227 | 48,227 | 327,000 | 50,685 |
| Total | \$ 1,428,123 | \$ 368,643 | \$ 377,760 | \$ 1,419,006 | \$ 869,752 |

| | 2012 | | | | |
|-------------------------------------|---------------------|-------------------|-------------------|---------------------|-------------------|
| | Beginning Balance | Additions | Deletions | Ending Balance | Current Portion |
| Accrued vacation leave | \$ 1,023,937 | \$ 540,993 | \$ 491,807 | \$ 1,073,123 | \$ 804,905 |
| Accrued worker's compensation costs | 379,882 | 37,675 | 62,557 | 355,000 | 55,025 |
| Total | \$ 1,403,819 | \$ 578,668 | \$ 554,614 | \$ 1,428,123 | \$ 859,930 |

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2013 and 2012

11. RELATED PARTY TRANSACTIONS

Maryland Correctional Enterprises utilizes low cost inmate labor for the manufacture of goods, wares, and merchandise sold and services rendered. Production facilities, warehouses, and offices are maintained at the Jessup Correctional Institution, the Maryland Correctional Institution-Hagerstown, the Maryland Correctional Institution-Jessup, the Maryland Correctional Institution for Women, the Maryland Correctional Training Center, the Roxbury Correctional Institution, Western Correctional Institution, Eastern Correctional Institution, Patuxent Institution, North Branch Correctional Institution and Central Maryland Correctional Facility. MCE reimburses the various institutions for certain utility costs (for example, fuel) and such costs are reflected in the financial statements. Improvements to the occupied facilities are made by MCE, as needed. Costs of building improvements are capitalized and are recorded as described in Note 2.

The Department of Public Safety and Correctional Services has not charged MCE rent for the space occupied, or for certain administrative costs incurred by the State of Maryland and the Department on behalf of MCE. Conversely, MCE has not charged the Department for the rehabilitative costs of training inmates. Accordingly, no recognition of these costs has been made in the accompanying financial statements.

12. TRANSFERS TO THE FEDERAL GOVERNMENT

According to the Federal OMB Circular A-87, the revenue generated by MCE for the sale of its products and services to Maryland's State agencies contain Federal funds. Each fiscal year MCE is required by the Department of Health and Human Services, a Federal agency, to conduct an analysis to determine if the retained earnings are in excess of stated guidelines. During fiscal year 2012 MCE paid \$391,945, including \$16,932 in interest for excess retained earnings related to fiscal year 2007 through fiscal year 2009. The analysis conducted for fiscal years 2010 and 2011 revealed no excess retained earnings. MCE estimated a liability of \$150,000 for the fiscal years ended June 30, 2013 and June 30, 2012.

13. TRANSFERS TO THE STATE'S GENERAL FUND

MCE transferred \$500,000 and \$325,000 to the State's General Fund as requested by the State of Maryland as part of its efforts to balance the State budget for the fiscal years ended June 30, 2013 and 2012, respectively.

MARYLAND CORRECTIONAL ENTERPRISES

Schedule of Cost of Sales and Services For the Year Ended June 30, 2013

Cost of Sales:

Beginning Inventory:

Finished Goods, July 1 \$ 5,990,185

Work in Process, July 1 \$ 615,169

Raw Materials:

Inventory, July 1 \$ 4,134,867

Purchases 27,418,706

Total Goods Available 31,553,573

Inventory, June 30 (4,512,708)

Raw Materials Used 27,040,865

Manufacturing Expenses:

Direct Labor:

Inmates 884,329

Incentive Pay to Inmates 849,983

Total Direct Labor 1,734,312

Other Manufacturing Expenses:

Indirect Labor 5,912,063

Operating Expenses 2,272,847

Miscellaneous 938,311

Total Other Manufacturing Expenses 9,123,221

Total Manufacturing Expenses 38,513,567

Ending Inventory:

Work in Process, June 30 (456,774)

Cost of Goods Manufactured 38,056,793

Finished Goods, June 30 (5,493,607)

Total Cost of Sales 38,553,371

Cost of Services:

Direct Labor - Inmates 231,013

Indirect Labor 982,384

Operating Expenses 1,563,414

Miscellaneous 370,534

Total Services Expenses 3,147,345

Total Cost of Services 3,147,345

Cost of Sales and Services

\$ 41,700,716

MARYLAND CORRECTIONAL ENTERPRISES

Schedule of Cost of Sales and Services For the Year Ended June 30, 2012

Cost of Sales:

| | | | |
|------------------------------------|-------------------|-------------------|-------------------|
| Beginning Inventory: | | | |
| Finished Goods, July 1 | | | \$ 4,187,510 |
| Work in Process, July 1 | | \$ 604,461 | |
| Raw Materials: | | | |
| Inventory, July 1 | \$ 4,372,393 | | |
| Purchases | 29,023,786 | | |
| Total Goods Available | <u>33,396,179</u> | | |
| Inventory, June 30 | (4,134,867) | | |
| Raw Materials Used | | 29,261,312 | |
| Manufacturing Expenses: | | | |
| Direct Labor: | | | |
| Inmates | 871,875 | | |
| Incentive Pay to Inmates | 903,121 | | |
| Total Direct Labor | <u>1,774,996</u> | | |
| Other Manufacturing Expenses: | | | |
| Indirect Labor | 5,772,064 | | |
| Operating Expenses | 2,209,866 | | |
| Miscellaneous | 993,891 | | |
| Total Other Manufacturing Expenses | <u>8,975,821</u> | | |
| Total Manufacturing Expenses | | <u>40,616,590</u> | |
| Ending Inventory: | | | |
| Work in Process, June 30 | | (615,169) | |
| Cost of Goods Manufactured | | | 40,001,421 |
| Finished Goods, June 30 | | | (5,990,185) |
| Total Cost of Sales | | | <u>38,198,746</u> |

Cost of Services:

| | | | |
|---|------------------|------------------|----------------------|
| Cost of Uncompleted Construction, July 1 | - | | |
| Direct Labor - Inmates | 286,382 | | |
| Indirect Labor | 992,761 | | |
| Operating Expenses | 1,684,258 | | |
| Miscellaneous | 438,493 | | |
| Total Services Expenses | <u>3,401,894</u> | | |
| Cost of Uncompleted Construction, June 30 | | - | |
| Total Cost of Services | | <u>3,401,894</u> | |
| Cost of Sales and Services | | | <u>\$ 41,600,640</u> |